

California Fair Political Practices Commission
MEMORANDUM

To: Chairman Getman, Commissioners Downey, Knox, and Swanson

From: John W. Wallace, Assistant General Counsel
Luisa Menchaca, General Counsel

Subject: Overview -- Conflict of Interest Regulations Improvement Project Revisions to Regulations 18704.2, 18705.1, 18707.9, and Proposal to Codify *In re Siegel* (1977) 3 FPPC Ops. 62

Date: August 26, 2002

INTRODUCTION

The Political Reform Act¹ (the “Act”) prohibits a public official from making, participating in making or otherwise using his or her official position to influence a governmental decision in which the official has a financial interest. (§ 87100 et seq.) In October and December 2001, staff presented several technical and substantive amendments to the interpretive regulations based upon input from the regulated community and staff review of issues that had arisen over the past year. The Commission directed staff to work on four new projects that were suggested by staff in the update memorandum.

On January 15, of this year, representatives of the California League of Cities asked that the Commission consider placing a regulation on the calendar codifying *In re Siegel* (1977) 3 FPPC Ops. 62. *Siegel* provides a test to apply which may result in members of nonprofit organizations being treated as “public officials” under the Act and generally covers quasi-public/private bodies created by public agencies. This was added as a fifth project for the Commission’s consideration.

On July 12, 2002, Commission staff conducted an Interested Persons meeting related to these topics, including the *Siegel* Opinion. The meetings were sparsely attended. However, based on the interested persons’ feedback and the Commission’s direction in December 2001, staff has returned with regulatory language dealing with three of the projects, and a brief update on one of the other projects pertaining to general plan decisions which will require further work and which will be presented to the Commission in November.

A. Historic Backdrop

In May 1998, the Commission initiated the Conflict of Interest Regulations Improvement Project and divided it into two phases. Phase 1 involved the restructuring of the regulations into a more “user-

1. Unless otherwise specified herein, all citations are to the Act at Government Code sections 81000 – 91014. All regulatory citations are to Commission regulations at Title 2, sections 18109 – 18997, of the California Code of Regulations.

friendly” format without making substantive changes. This was completed in November 1998 and resulted in an eight-step analysis that is applied to determine whether a public official has a conflict of interest in a given governmental decision. This analysis is outlined below.

Phase 2 included the substantive amendment to the regulations. These were adopted in December 2000 and were effective on February 1, 2001. Phase 2 resulted in the adoption of, or amendment to, regulations 18230, 18232, 18701, 18702.1, 18703.5, 18704.2, 18704.5, 18705, 18705.1, 18705.2, 18705.3, 18705.5, 18707, 18707.1 - 18707.3, 18707.7, 18707.9, 18708, and 18730.

B. Current Projects

The current projects all serve as refinements to the regulatory foundation for the eight-step process. These projects are discussed below in their context within the formal analytical framework.

Step One: Is the individual a “public official?”

In this step, the threshold determination is made as to whether the individual comes within the purview of the Act in his or her official capacity.

***In re Siegel* (1977) 3 FPPC Ops. 62.** On January 15 of this year, representatives of the California League of Cities asked that the Commission consider placing a regulation on the calendar codifying *In re Siegel* (1977) 3 FPPC Ops. 62. *Siegel* provides a test which may result in members of nonprofit organizations being treated as “public officials” under the Act, and generally covers quasi-public/private bodies created by public agencies. The *Siegel* opinion sets forth a four-part test to determine if a corporation is in fact a “local government agency.” The four criteria are:

- (1) Whether the impetus for formation of the corporation originated with a local government agency;
- (2) Whether it is substantially funded by, or its primary source of funds is, a government agency;
- (3) Whether one of the principal purposes for which it is formed is to provide services or undertake obligations which public agencies are legally authorized to perform, and which, in fact, they traditionally have performed; and
- (4) Whether the corporation is treated as a public agency by other statutory provisions.

To date, we have examined each advice letter request as to whether a corporation or a private nonprofit corporation is a “local government agency” (section 82041) on a factual, case-by-case basis using the above criteria to make a determination. If the corporation is found to be a “local

government agency,” then the individuals who serve on the board of directors are “public officials” under the Act and are subject to the disclosure and conflict-of-interest provisions of the Act.

At the Interested Persons’ meeting, we requested specific examples and information about private, nonprofit corporations and the function they serve as to local city government. We are in on-going communication with representatives of the League and anticipate presenting an update to the Commission with possible regulatory action next year. This project will necessitate extensive review of our previous advice letters, as well as some Interest Persons meetings. Due to our very heavy regulation schedule for this year, it is not possible to address this issue before 2003.

Step Two: Is the public official making, participating in making, or influencing a governmental decision?

In this step, the nature of the public official’s participation in a given governmental decision is examined to assure that he or she is actually involved in making a governmental decision, as opposed to a private decision, within the meaning of the Act.

Step Three: What is the “economic interest” of the public official?

In this step, the economic interests that may give rise to a financial interest in a given governmental decision are identified. The various economic interests of a public official are as follows:

- *Business Interests.* An official has an economic interest in a business entity in which the official, the official’s spouse, the official’s dependent children, or anyone acting on the official’s behalf has invested \$2,000 or more, or in which the official is a director, officer, partner, trustee, employee, or holds any position of management.
- *Real Property.* The official has an economic interest in real property in which the official, the official’s spouse, the official’s dependent children, or anyone acting on the official’s behalf has invested \$2,000 or more (including leasehold interests).
- *Sources of Income.* The official has an economic interest in any person, whether an individual or an organization, from whom the official has received (or by whom the official has been promised) \$500 or more in income within the 12 months prior to the decision.
- *Sources of Gifts.* The official has an economic interest in anyone, whether an individual or an organization, which has given the official gifts totaling \$320 or more within the 12 months prior to the decision.
- *Personal Finances.* The official has an economic interest in the official’s personal expenses, income,

assets, or liabilities, as well as those of the official's immediate family--this is known as the "personal financial effects" rule. If the decision will affect the official's personal finances by \$250 or more, then a conflict of interest exists.

Step Four: Are the public official's economic interests directly or indirectly involved in the decision?

In this step, the nature of the involvement of the public official's economic interest in the governmental decision is examined. Depending on the type of economic interest involved, different standards are applied to determine whether an economic interest is directly or indirectly involved in a governmental decision. Generally, where an economic interest is directly involved in a governmental decision, more stringent rules are applied in determining whether a decision has a disqualifying effect on the official's economic interest under subsequent steps in the conflicts analysis.

ATTACHED PROJECT MEMORANDUM: Five-Hundred Foot Test: Regulation 18704.2 sets out a list of factual situations in which an official's real property interest is considered directly involved in a governmental decision. In December of 2000, the Commission added two situations (formerly defined as "indirect" situations) to regulation 18704.2. The new provisions dealt specifically with (a) real property located within 500 feet of the boundaries (or proposed boundaries) of the real property which is the subject of the governmental decision, and (b) decisions involving the construction of, or improvements to, streets, water, sewer, storm drainage or similar facilities. An issue has arisen as to whether the "500-foot rule" embodied in regulation 18704.2 is applicable only to the decisions expressly set forth in the regulation, or whether it can be applied to decisions that are not expressly included in the regulation. It can be argued, under a literal reading of the regulation that an official with real property within 500 feet (or 50 feet, for that matter) of real property subject to a decision, which is not expressly listed in (a)(1) through (a)(5), would still gain the benefit of presumption of nonmateriality. The Commission has directed staff to investigate clarifying amendments to this regulation which will show that the "500-foot" test is not limited to the list of decisions in the regulation.

General Plans: Some agencies viewed general plan amendments as coming within the purview of "zoning or rezoning" decisions under subdivisions (a)(1) and (a)(5) of the regulation. Because general plans cover the entire jurisdiction, officials of these agencies are often not able to participate in such decisions unless the "public generally" or "legally required participation" exceptions apply. This results in substantial difficulties, in that all of the members of a governing board of an agency may be unable to participate in some of the most fundamental decisions affecting the entire jurisdiction. The County of San Diego, in particular, has expressed frustration with the conflict-of-interests analysis as it applies to general plan decisions.

Staff has explored the possibility of regulatory amendments dealing with this problem, possibly falling in this step, which deals with measuring material financial effects. Other approaches are also feasible,

such as the development of a “public generally” rule unique to general plan decisions. Staff would like to hold an Interested Persons’ meeting in San Diego to explore specific approaches and to gather more information. Staff would present regulatory language to the Commission for pre-notice discussion in November 2002 and adoption in January 2003.

Steps Five and Six: Will the financial effect of the decision on the public official’s economic interests be material and reasonably foreseeable?

While these are distinct steps in the analytical framework, they are usually combined to determine whether a decision will have a reasonably foreseeable material financial effect on the official’s economic interest.

ATTACHED PROJECT MEMORANDUM: Business Entity Materiality: Regulation 18705.1 sets forth the materiality standards applicable to business entities in which the public official has an economic interest. The regulation also refers to the Fortune 500 and the listing criteria for various stock exchanges as alternative materiality thresholds (where the business is not actually listed), applicable according to the economic value or economic activity of a business. Put another way, these are self-adjusting thresholds that apply different materiality standards to businesses of different sizes.

There has been feedback from the regulated community to the effect that the listing criteria for the various exchanges are too complex for officials to use in determining the materiality standard to be applied to an economic interest in a business entity. Staff has reviewed regulation 18705.1 for possible clarifying amendments.

Steps Seven and Eight: Does the governmental decision come within any exception to the conflict-of-interest rules?

There are two exceptions with many variants. These exceptions are applied to allow a public official with a conflict of interest to still participate in the governmental decision. The first of these exceptions is for decisions where the effect on the public official’s economic interest(s) is not different from the effect on the economic interest(s) of the “public generally.” The second exception is applied where the participation of the public official is “legally required.”

ATTACHED PROJECT MEMORANDUM: Small Jurisdiction Regulation: Regulation 18707.3 provides an exception geared specifically toward small jurisdictions. Several amendments were made to this regulation to make it consistent with the amended materiality regulations applicable to real property. The City of Yountville has raised concerns with the application of this regulation because it incorporates the “500-foot” rule as one of the preconditions for application of the “public generally” exception for small jurisdictions. Some small jurisdictions have found that a radius of 500 feet from each of the residences of city council members encompasses much of the jurisdiction. Staff has reviewed the

regulation to see if language can be tailored to meet this unique concern of small cities.